102 H

(11)

No. 06-484

FILED
FEB 9 - 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

TELLABS, INCORPORATED and RICHARD C. NOTEBAERT,

Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., *et al.*

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR PIXELPLUS CO., LTD. AND QUEST SOFTWARE, INC. AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

WILLIAM F. SULLIVAN
Counsel of Record
KIMBERLEY A. DONOHUE
PAUL, HASTINGS, JANOFSKY
& WALKER LLP
3579 Valley Centre Drive
San Diego, CA 92130
(858) 720-2500

STEVEN T. CATLETT
PAUL, HASTINGS, JANOFSKY
& WALKER LLP
191 N. Wacker Drive
30th Floor
Chicago, IL 60606

PETER M. STONE
JOHANNA S. WILSON
PAUL, HASTINGS, JANOFSKY
& WALKER LLP
695 Town Center Drive
17th Floor
Costa Mesa, CA 92626

MATTHEW F. STOWE
PAUL, HASTINGS, JANOFSKY
& WALKER LLP
875 15th Street, N.W.
Washington, DC 20005

Attorneys for Amici Curiae

TABLE OF CONTENTS

Page

INTERESTS OF THE *AMICI CURIAE* 1

SUMMARY OF THE ARGUMENT 3

ARGUMENT 6

I. THE SEVENTH CIRCUIT'S "COULD INFER" STANDARD IS INCONSISTENT WITH THE REFORM ACT'S PLAIN LANGUAGE 6

II. THE "MOST PLAUSIBLE" STANDARD ADOPTED BY THE PLURALITY OF COURTS CONFORMS TO THE REFORM ACT'S PLAIN LANGUAGE AND STATUTORY PURPOSE 8

A. The "Most Plausible" Test is Supported by the Plain Language of the Statute 8

B. The "Could Infer" Standard Would Produce Unreasonable Results and Undermine the Statutory Purpose 10

(a) Result Under the "Could Infer" Standard? 13

(b) Result Under the "Most Plausible" Standard? 13

III. THE REFORM ACT'S HEIGHTENED PLEADING STANDARD PARALLELS THE STANDARD IN SIMILAR COMMON LAW FRAUD CASES WHICH HAVE NEVER RAISED CONSTITUTIONAL CONCERNS 15

IV. CONCLUSION 17

TABLE OF AUTHORITIES

Page(s)

Cases:

Acito v. IMCERA Group, Inc.,
47 F.3d 47 (2d Cir. 1995).....14

In re Advanta Corp. Sec. Litig.,
180 F.3d 525 (3d Cir. 1999).....14

Arnett v. Sanderson,
218 P. 986 (Ariz. 1923).....16

Baltimore & Carolina Line, Inc. v. Redman,
295 U.S. 654 (1935).....4

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975).....10, 15

Carrillo v. Fabian,
701 N.W.2d 763 (Minn. 2005).....16

In re Credit Suisse First Boston Corp. Analyst Reports Sec. Litig.,
431 F.3d 36 (1st Cir. 2005).....9

DiLeo v. Ernst & Young,
901 F.2d 624 (7th Cir. 1990) 8

Dura Pharms., Inc. v. Broudo,
544 U.S. 336 (2005)..... *passim*

TABLE OF AUTHORITIES
(continued)

Page

Ernst & Ernst v. Hochfelder,
425 U.S. 185 (1976).....15

In re First Union Corp. Sec. Litig.,
128 F. Supp. 2d 871 (W.D.N.C. 2001).....14

Gompper v. VISX, Inc.,
298 F.3d 893 (9th Cir. 2002) 9-12

Greebel v. FTP Software, Inc.,
194 F.3d 185 (1st Cir. 1999).....14

Harlow v. Fitzgerald,
457 U.S. 800 (1982).....4

Helwig v. Vencor, Inc.,
251 F.3d 540 (6th Cir. 2001) ..... *passim*

Kowal v. MCI Commc'ns, Corp.,
16 F.3d 1271 (D.C. Cir. 1994).....8

Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit,
507 U.S. 163 (1993).....4

Melder v. Morris,
27 F.3d 1097 (5th Cir. 1994) 8

Ottman v. Hanger Orthopedic Grp., Inc.,
353 F.3d 338 (4th Cir. 2003) 9

TABLE OF AUTHORITIES
(continued)

Page

Ronconi v. Larkin,
253 F.3d 423 (9th Cir. 2001) 14

Ross v. Powell,
206 S.W.3d 327 (Ky. 2006) 16

Scheuer v. Rhodes,
416 U.S. 232 (1974) 4

In re Silicon Graphics Sec. Litig., 183 F.3d 970,
974 (9th Cir. 1999) 14

Swierkiewicz v. Sorema N.A.,
534 U.S. 506 (2002) 4

Travelers Indemn. Co. v. Armstrong,
442 N.E.2d 349 (Ind. 1982) 16

In re Vantive Corp. Sec. Litig.,
283 F.3d 1079 (9th Cir. 2002) 14

West v. Prudential Sec., Inc.,
282 F.3d 935 (7th Cir. 2002) 11

TABLE OF AUTHORITIES
(continued)

Page

Statutes, Regulations, and Rules:

15 U.S.C. § 78u-4 ..... *passim*

Private Securities Litigation Reform Act of 1995,
Pub. L. No. 104-67, 109 Stat. 737 ..... *passim*

Federal Rules of Civil Procedure
Rule 9(b) 4, 8
Rule 12(b)(6) 4, 9

17 C.F.R. § 240.10b5-1 ..... 13, 14

Legislative History:

H.R. Rep. No. 104-369 (1995),
reprinted in 1995 U.S.C.C.A.N. 730 6

S. Rep. No. 104-98 (1995),
reprinted in 1995 U.S.C.C.A.N. 679 5

Secondary Sources:

Restatement (Second) of Torts § 525 (1976) 16

BRIEF OF *AMICI CURIAE* IN SUPPORT OF PETITIONERS

This brief is filed on behalf of Pixelplus Co., Ltd. (Pixelplus), and Quest Software, Inc. (Quest) in support of petitioners, with the written consent of the parties.[1]

INTERESTS OF THE *AMICI CURIAE*

Amici are high technology companies currently defending their interests in separate securities class actions in New York[2] and California,[3] and would directly benefit from a uniform standard for pleading scienter consistent with the plain language and clear purpose of the Private Securities Litigation Reform Act of 1995 ("Reform Act"). Pub. L. No. 104-67, 109 Stat. 737 (1995).

[1] *Amici* affirm that no counsel for a party has written this brief in whole or in part and that no person or entity, other than the *Amici,* their members, or their counsel, has made a monetary contribution to the preparation and submission of this brief. *Amici* further state that they do not have parent corporations and that there is no publicly held company that owns 10% or more of the stock of Pixelplus or Quest.

[2] Pixelplus is a defendant named in a number of complaints filed in the Southern and Eastern Districts of New York that have yet to be consolidated which are based upon alleged misstatements made in its December, 2005 offering of American Depositary Shares in the United States.

[3] Quest is a defendant in the Central District of California in a case regarding its financial restatement relating to an options grant practice review.

Pixelplus, with headquarters in South Korea and subsidiaries in Northern California, China and Taiwan, designs, develops and markets images sensors and applications with a focus on the mobile handset market.

Quest, a California corporation with headquarters in Southern California and offices or distribution centers across the nation and sixty-four other countries, designs, develops, distributes and supports software products that improve the performance and productivity of its customers' packaged and custom software applications and associated software infrastructure components.

Amici compete in the volatile high-tech global marketplace which is characterized by complex, rapidly changing technologies and intense competitive pressures. To maintain a competitive position in this environment, companies expend far greater resources than is typical of other industries on research and development, marketing and distribution, which are necessary to enhance existing products and develop new products to address customer needs. As a result, companies such as these operate in volatile markets, and are especially vulnerable to the coercive nature of strike suits that have an effect of pressuring defendants to settle merit-less actions due to the high cost of litigation.

Amici offer guidance on matters that are of special concern to domestic and foreign issuers in emerging growth industries like the communications and software markets, and respectfully request that this Court reverse the court below and adopt a uniform standard effectuating the plain language and purpose of the Reform Act.

SUMMARY OF THE ARGUMENT

In the decade since Congress enacted the Reform Act, the courts of appeal have struggled to establish a uniform standard for pleading scienter. With the decision below, there are at least four different interpretations of the Reform Act's standard for pleading scienter.

Yet, despite this lack of uniformity, *all* federal courts of appeal – with the exception of the court below – allow some consideration of innocent inferences to determine whether plaintiffs have pled facts showing a strong inference of scienter. Indeed, beyond just considering innocent inferences, the plurality of courts of appeal have followed the Sixth Circuit's clear holding that only where a culpable inference of scienter is the "most plausible" to be drawn will a complaint withstand dismissal.

The Seventh Circuit's recent adoption of a "could infer" standard is by far the most lax standard among its sister circuits, not to mention pre-Reform Act standards. The court's refusal to allow courts to consider competing innocent inferences arising out of the alleged facts is contrary to the Reform Act's plain language which requires plaintiffs to plead a "strong inference" of scienter (15 U.S.C. § 78u-4(b)(2)), and deprives defendants of even the pre-Reform Act standards for pleading scienter generally.

The Seventh Circuit's "could infer" standard appeared to be motivated from the court's concern that the more rigorous standard followed by the plurality of other circuits – and required by the Reform's Act heightened standard – requires district courts to infringe upon the

jury's role as fact-finders by weighing all inferences that flow from the alleged facts. This concern, however, is unwarranted and ignores the body of common law that has required heightened pleading and proof for fraud, and under which many courts were required to consider evidence at summary judgment under a heightened "clear and convincing" standard.

Moreover, the Reform Act's heightened pleading burden for scienter is a procedural matter, and a question of law, and does not implicate the jury's fact-finding role. *See Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974), *overruled on other grounds*, *Harlow v. Fitzgerald*, 457 U.S. 800 (1982) (finding that the Constitutional right to a jury trial is not implicated at the motion to dismiss stage because "the issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims"); *see also Baltimore & Carolina Line, Inc. v. Redman*, 295 U.S. 654, 657 (1935) (noting that the Seventh Amendment is not implicated where matters of procedure and issues of law are concerned). In addition, Congress was well within its power to impose higher pleading requirements for securities cases than those generally required in Rule 9(b) or 12(b)(6) of the Federal Rules of Civil Procedure. *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 512-13 (2002); *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993).

The "could infer" standard also runs counter to the Reform Act's clear purpose of discouraging strike suits[4] that, if allowed to move forward, present companies with a Hobson's choice of paying the high cost to defend a meritless suit versus settling up front for a nuisance value, and will likely result in higher defense and insurance costs.[5] This environment is also more likely to force foreign issuers to withdraw prematurely their listings within markets in the United States, depriving issuers from sources of capital, issuer employees from a form of compensation and public investors from investment alternatives.[6] This increased burden on valued and significant segments of the economy, as well as this Court's recent admonition against using the securities laws as a form of secondary insurance,[7] reason in favor of rejecting the Seventh Circuit's "could infer" standard.

---

[4] *See* S. Rep. No. 104-98, at 4, reprinted in 1995 U.S.C.C.A.N. 679, 683. (noting that the Reform Act has the purpose of discouraging strike suits containing claims that were often "based on nothing more than a company's announcement of bad news, not evidence of fraud").

[5] *See* S. Rep. No. 104-98, at 9, reprinted in 1995 U.S.C.C.A.N. 679, 688 (observing that prior to the Reform Act, defendants often settled quickly regardless of merit in order to avoid the expense and risk of litigation); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 347-48 (2005).

[6] *See* S. Rep. No. 104-98 at 4, *reprinted in* 1995 U.S.C.C.A.N. 679, 683 (noting that the resulting expense of strike suites was borne indirectly by the capital markets by imposing increased costs on capital formation to the detriment of investors and companies in the United States).

[7] *Dura*, 544 U.S. at 347-48 (rejecting a rule for pleading loss causation that "would tend to transform a private securities action into a partial downside insurance policy.") (citations omitted).

The fundamental unsoundness of the Seventh Circuit's approach is underscored by the strategic ambiguities it encourages plaintiffs to create in their complaints to a state a claim in even the weakest case. As the hypothetical discussed below helps to show (*infra at* 13-15), the Seventh Circuit's "could infer" rule invites speculation, and reads the heightened pleading requirement out of the statute. This is contrary to the plain language of the Reform Act and would allow a standard even more lax than that in place prior to the Reform Act to govern cases brought within the Seventh Circuit. This is precisely the type of disparate result the Reform Act was designed to address.

Given the disparity in approaches by the courts of appeal, a uniform rule is needed to establish the uniformity the Reform Act was enacted to create. *See* H.R. Rep. No. 104-369, at 41, *reprinted in* 1995 U.S.C.C.A.N. 730, 740 (explaining that one of the purposes of the Reform Act is to create "uniform and more stringent pleading requirements"). The plurality of circuits have already adopted a rule which carries out the plain language and purpose of the Reform Act and that standard should be adopted as the uniform rule.

ARGUMENT

I. THE SEVENTH CIRCUIT'S "COULD INFER" STANDARD IS INCONSISTENT WITH THE REFORM ACT'S PLAIN LANGUAGE

The Seventh Circuit has adopted a "could infer" scienter pleading standard that is irremediably at odds with the Reform Act. As this Court explained in *Dura*

Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336 (2005), the Reform Act "insists that securities fraud complaints . . . 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'" 544 U.S. at 345-46 (quoting 15 U.S.C. § 78u-4(b)(1), (2)).

As *Dura* recognized, the plain language of the Reform Act requires that plaintiffs plead a "strong inference" of scienter, which in turn requires district courts to weigh competing inferences to determine whether combined inferences in favor of scienter are "strong." The Reform Act's plain language thus requires a district court do more than simply accept the inferences that "could" plausibly be drawn from plaintiff's allegations. For if only inferences favorable to plaintiff could ever be considered, how then would a district court ever conclude that they were not strong?

For example, in the vast majority of cases a CEO who was committing fraud would never buy massive amounts of stock during the class period. It is remotely conceivable, however, that a CEO could sacrifice his personal wealth to cover up a fraud at the company. Confronted with the competing inferences that can be drawn from the same alleged fact, the decision below veritably requires courts to infer a cover-up (a weighty inference indeed to any CEO who, in all probability, stands wrongly accused), because every inference that could be drawn from the stock purchases must be drawn in the plaintiff's favor.

In this regard, the Seventh Circuit's decision would impermissibly read the heightened pleading requirement

out of the statute, and would impose a standard even more lax than in pre-Reform Act cases. In essence, the "could infer" standard is a "can't miss" for plaintiffs. It was never the law that the district courts would infer anything they could infer in favor of a complaint, no matter how implausible. *Reasonable* inferences were always to be drawn even in pre-Reform Act times – including in the Seventh Circuit. *See, e.g.*, *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990) (holding that even under Rule 9(b), conclusory allegations are insufficient, and cautioning courts not to "indulg[e] ready inferences of irrationality"); *Kowal v. MCI Commc'ns, Corp.*, 16 F.3d 1271, 1276 (D.C. Cir. 1994) (affirming dismissal and explaining, "the court need not accept inferences drawn by plaintiffs if such inferences are unsupported by the facts"); *cf. Melder v. Morris*, 27 F.3d 1097, 1102 (5th Cir. 1994) (rejecting conclusory motive allegations regarding defendants' position or compensation as this "would effectively eliminate the state of mind requirement" in "'a nihilistic approach to Rule 9(b) jurisprudence'" and ruling that absent adequate motive allegations, plaintiffs must "face a tougher standard for establishing fraudulent intent").

II. THE "MOST PLAUSIBLE" STANDARD ADOPTED BY THE PLURALITY OF COURTS CONFORMS TO THE REFORM ACT'S PLAIN LANGUAGE AND STATUTORY PURPOSE

A. The "Most Plausible" Test is Supported by the Plain Language of the Statute

The plurality of circuits permit district courts to consider innocent inferences in determining whether plaintiffs have pled facts giving rise to a strong inference of

scienter. The Sixth Circuit was the first to articulate what has become the plurality rule that the Reform Act entitles plaintiffs "only to the most plausible of competing inferences" from the facts alleged in the complaint, and explained that this standard derives from the Reform Act and "represents a significant strengthening of the pre-[Reform Act] standard under Rule 12(b)(6)." *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001).

Following the Sixth Circuit's decision in *Helwig*, three of its sister circuits adopted the same "most plausible" standard. *See In re Credit Suisse First Boston Corp. Analyst Reports Sec. Litig.*, 431 F.3d 36, 49 (1st Cir. 2005); *Ottman v. Hanger Orthopedic Grp., Inc.*, 353 F.3d 338 (4th Cir. 2003); *Gompper v. VISX, Inc.*, 298 F.3d 893 (9th Cir. 2002).

Even the Ninth Circuit – which prior to the Reform Act arguably had the most lenient standard for pleading a securities fraud claim – followed the Sixth Circuit's "most plausible" test, holding that the court should consider "any reasonable inferences that can be drawn" from scienter allegations. *Gompper*, 298 F.3d at 896-97.

The Ninth Circuit squarely rejected the claim that innocent inferences at the pleading stage can be ignored, explaining that this approach would "eviscerate the [Reform Act's] strong inference requirement by allowing plaintiffs to plead in a vacuum." *Id.* Indeed, the court reasoned that because the statute's plain language "made it crystal clear that the [Reform Act's] pleading requirements were put in place so that only complaints with particularized facts giving rise to a strong inference of wrongdoing survive," a district court "*must* consider *all*

reasonable inferences . . . including inferences unfavorable to the plaintiffs." *Id.* (emphasis added).

In stark contrast, the Seventh Circuit below adopted an expansive "could infer" standard that rejects the plurality rule and disregards the plain language of the Reform Act. This Court should confirm the Reform Act's basic standard that a strong inference of scienter must be established by alleging facts requiring that the culpable inference give rise to a "strong inference" of scienter – or as the plurality would state, is the "most plausible" one.

B. The "Could Infer" Standard Would Produce Unreasonable Results and Undermine the Statutory Purpose

The Ninth Circuit properly characterized the type of standard ultimately adopted by the Seventh Circuit as "thwart[ing] Congress's basic purpose in raising the bar in the first place; namely, to eliminate abusive and opportunistic securities litigation and to put an end to the practice of pleading fraud by hindsight." *Gompper*, 298 F.3d at 896-97. To this end, the Seventh Circuit's "could infer" rule undermines the Reform Act's express goal of preventing vexatious private securities litigation by enabling plaintiffs to resort to the type of ambiguous and conclusory allegations that the Reform Act is designed to prevent. As this Court cautioned in *Dura*, lax pleading standards pose a coercive threat to defendants because a plaintiff "with a largely groundless claim [could] . . . simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value." *Dura*, 544 U.S. at 347-48 (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741

(1975)). Tolerating such lax pleadings in the loss causation context would "tend to transform a private securities action into a partial downside insurance policy." *Id.* (citations omitted). Ironically, the Seventh Circuit itself also has recognized this fact: "[S]ettlements in securities cases reflect high risk of catastrophic loss, which together with imperfect alignment of managers' and investors' interests leads defendants to pay substantial sums even when the plaintiffs have weak positions." *West v. Prudential Sec., Inc.*, 282 F.3d 935, 937 (7th Cir. 2002).

In *Gompper*, the Ninth Circuit further demonstrated the absurd result that could have been reached in that case by excluding innocent inferences from the facts alleged in the complaint, a result that would have undermined the purposes of the Reform Act:

> [T]he complaint sets out in great detail VISX's tendency to sue its competitors for patent infringement. Plaintiffs argue that one reasonable and warranted inference one could draw from VISX's litigation pattern is that VISX knew its patents were invalid and, consequently, engaged in an aggressive strategy of intimidation through litigation. . .
>
> Of course, ***it is equally if not more plausible*** that VISX consistently initiated litigation in defense of its patents because it and its officers believed the patents were valid, and recognized that the very survival of VISX's business model was contingent on the technology protected by these patents. ***Consideration of this inference quite***

> ***clearly impedes the plaintiffs' progress toward building the requisite strong inference of scienter.***

Gompper, 298 F.3d at 896-97 (emphasis added).

The "most plausible" standard thus best effectuates the clearly articulated heightened pleading standard under the Reform Act by requiring plaintiffs to live with all of the inferences – good and bad – created by the allegations they choose to include in the complaint.

The Seventh Circuit's "could infer" is the most lenient of any circuit and would encourage rather than diminish securities complaints supported only by conjectural claims of scienter. Consider how the following hypothetical case (based, however, on real world experience of many public companies) could well be resolved differently under the "could infer" versus the "most plausible" standard:

- **Hypothetical:**

Plaintiffs' Complaint alleges that the CEO of Company X made material misstatements concerning the financial health of Company X. Plaintiffs allege that the CEO sold 3 million shares of stock during the class period of sixteen months which was alleged to be unusual and suspicious. But the pleadings or judicially noticeable documents and facts also show (1) that his holdings in Company X during the relevant time period were in excess of 60 million shares (i.e., the sale of 3 million shares represented only 5% of his stock holdings in Company X during the class period), (2) that the 3 million shares of

stock were sold pursuant to a previously disclosed and non-discretionary Rule 10b5-1 plan, and (3) that the CEO actually purchased 6 million shares toward the end of the class period. With regard to this last fact, Plaintiffs allege without further factual support that the purchase was made to cover up the CEO's participation in the alleged fraud.

(a) Result Under the "Could Infer" Standard?

Under the Seventh Circuit's "could infer" approach, it is possible that the district court only should consider the sales of stock, not the percentage of sales or their non-discretionary nature. It might also be possible under this standard that the district court, while finding it very unlikely, "could infer" that the purchases were part of a cover up. In that case, the overwhelmingly reasonable inferences that might be drawn about the CEO's innocent mental state due to minimal stock sales, purchases of twice as many shares, and the Rule 10b5-1 plan are excluded as allegedly improper, and only the fact that the CEO sold stock and perhaps attempted some cover up is considered. Since stock sales by officers during an alleged class period are often seen by courts as strong evidence of scienter, the complaint may survive a motion to dismiss. Presumably evidence of a "cover up" via purchases would also raise some inference of scienter.

(b) Result Under the "Most Plausible" Standard?

In contrast, the plurality of circuits would not only consider the innocent inferences created by the CEO's stock holdings during the class period and the non-

discretionary nature of the sales made as part of a disclosed Rule 10b5-1 plan, they would find that the remaining culpable inferences of insider trading are not the "most plausible" inference from the facts and would accordingly grant the CEO's motion to dismiss. *See In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999); *see also In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1094-95 (9th Cir. 2002); *Ronconi v. Larkin*, 253 F.3d 423, 435 (9th Cir. 2001); *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 197-98 (1st Cir. 1999).

Similarly, the plurality's "most plausible" standard would clearly find that the CEO's purchase of shares during the class period tends to negate scienter. *See, e.g., In re First Union Corp. Sec. Litig.*, 128 F. Supp. 2d 871, 899 (W.D.N.C. 2001) (an insider's purchase of stock during the class period "is wholly inconsistent with [plaintiffs'] contention that he knew undisclosed negative information about the Company"); *see also, In re Advanta Corp. Sec. Litig.*, 180 F.3d 525 (3d Cir. 1999) (holding that the sale of no stock during the class period by three insiders negates an inference of scienter); *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995) ("The fact that the other defendants did not sell their shares during the relevant class period undermines plaintiffs' claim that defendants delayed notifying the public so that they could sell their stock at a huge profit." (internal quotations omitted)).

In sum, allowing plaintiffs to exclude the innocent inferences stemming from these facts improperly permits an end-run around the reforms Congress enacted over a decade ago and should be rejected in favor of the "most plausible" standard.

III. THE REFORM ACT'S HEIGHTENED PLEADING STANDARD PARALLELS THE STANDARD IN SIMILAR COMMON LAW FRAUD CASES WHICH HAVE NEVER RAISED CONSTITUTIONAL CONCERNS

In adopting the "could infer" standard, the Seventh Circuit appeared concerned that the more rigorous standard followed by other circuits somehow would infringe upon the Constitutional right to a jury trial by requiring the district courts to engage in fact-finding. But any such concern ignores the fact that heightened pleading and proof always has been required at common law for frauds of all types, and that, for example, district courts for many years have had to measure evidence at summary judgment against a heightened "clear and convincing" standard for common law fraud.

As this Court noted in *Dura*, because the right to bring a securities fraud action is implied under the statute, courts properly may look to the common law for guidance. *Dura*, 544 U.S. at 341, 346. Moreover, the Reform Act "makes clear Congress' intent to permit private securities fraud actions for recovery where, but only where, plaintiffs adequately allege and prove the traditional elements of causation and loss." *Id.* at 346. Just as traditional elements of causation and loss apply for purposes of determining whether plaintiffs have pled the element of loss causation, traditional elements of deceit and misrepresentation likewise apply. *Id. at* 341 (citing *Blue Chip Stamps*, 421 U.S. at 730, 744; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976)). To this end, both the securities fraud claims and the common law claims require the plaintiff establish certain identical elements, including material

misrepresentation, justifiable reliance and causation. *Id.* at 343-44 (citing Restatement (Second) of Torts § 525, p. 55 (1976)).

For many years, a majority of common law jurisdictions have required plaintiffs pleading fraud to establish their claims by clear and convincing evidence.[8] And, certain jurisdictions which do not require clear and convincing proof still require something more than a preponderance of the evidence.[9]

Congress' enactment of a requirement that a securities fraud plaintiff plead a "strong inference of scienter" is well in keeping with this common law tradition of heightened proof of fraudulent conduct. And, to the best of *Amici*'s understanding, it has never been of Constitutional concern that district courts considering common law fraud claims would examine the facts at, for example, a summary judgment stage, to see if they met these types of heightened standards for fraud. Only by such measuring could the courts determine whether or not the evidence met a clear and convincing standard.

---

[8] *See, e.g., Ross v. Powell*, 206 S.W. 3d 327 (Ky. 2006); *Carrillo v. Fabian*, 701 N.W.2d 763 (Minn. 2005).

[9] *See, e.g., Arnett v. Sanderson*, 218 P. 986, 990 (Ariz. 1923) (while "proof of fraud should be clear and convincing ... fraud is determined by a preponderance of the evidence"). Other states require plaintiff to prove common law fraud by a preponderance of the evidence. *See, e.g., Travelers Indem. Co. v. Armstrong*, 442 N.E. 2d 349 (Ind. 1982) (also holding that fraud in cases of equity must be shown by clear and convincing evidence).

CONCLUSION

For the reasons presented above, the judgment of the court of appeals should be reversed, and the case remanded.

Respectfully submitted.

WILLIAM F. SULLIVAN
Counsel of Record
KIMBERLEY A. DONOHUE
Paul, Hastings, Janofsky & Walker LLP
3579 Valley Centre Drive
San Diego, CA 92130
(858) 720-2500

STEVEN T. CATLETT
Paul, Hastings, Janofsky & Walker LLP
191 N. Wacker Drive
30th Floor
Chicago, IL 60606
(312) 499-6000

PETER M. STONE
JOHANNA S. WILSON
Paul, Hastings, Janofsky & Walker LLP
695 Town Center Drive
17th Floor
Costa Mesa, CA 92626
(714) 668-6200

MATTHEW F. STOWE
Paul, Hastings, Janofsky & Walker LLP
875 15th Street, N.W.
Washington, DC 20005
(202) 551-1700

February 2007